Internal Revenue Service

memorandum

CC:INTL
Brl:WEWilliams

date:

to: District Director, Milwaukee District
Attn: Mr. Dave Wagner, revenue agent

from: Chief, Branch No. 1
Associate Chief Counsel (International) CC:INTL:1

subject: [redacted]

THIS DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE OUTSIDE THE IRS, INCLUDING THE TAXPAYERS INVOLVED, AND ITS USE WITHIN THE IRS SHOULD BE LIMITED TO THOSE WITH A NEED TO REVIEW THE DOCUMENT FOR USE IN THEIR OWN CASES.

This refers to the telephone conversation between Ed Williams of this office and you on May 16, 1991, and to the copy of the exemption certificate that you faxed to this office. You requested any views that we have concerning a matter that involves the insurance premium excise tax imposed by I.R.C. § 4371.

As we understand the facts, you are examining the [redacted] federal income tax return filed by [redacted], a U.S. corporation (hereinafter "taxpayer"). Taxpayer purchased insurance from and paid premiums directly to a French insurance company, [redacted], during [redacted]. The effective date of the insurance contract was [redacted]. Taxpayer did not withhold and payover excise tax on the premiums it paid to the French company. Your question is whether tax should have been paid by taxpayer under section 4371 on the premium payments.

Section 4371 imposes a tax on each policy of insurance or reinsurance issued by any foreign insurer or reinsurer. Section 4374 provides that the tax imposed by section 4371 shall be paid by any person who makes, signs, issues, or sells any of the documents and instruments subject to the tax, or for whose use or benefit the same are made, signed, issued or sold. Section 46.4374-1(a) of the Excise Tax Regulations provides that, in the case of premiums paid on or after January 1, 1966, the tax imposed by section 4371 shall be paid on the basis of a return. Such tax shall be remitted by the person who makes the payment of the premium to a foreign insurer or reinsurer or to any nonresident agent, solicitor, or broker. The phrase "person who makes the payment" means the resident person who actually transfers the money, check, or its equivalent to the foreign insurer or reinsurer or to any nonresident agent, solicitor, or broker.

Article 1 of the United States - France Income Tax Convention includes the federal excise tax on insurance premiums as a covered tax. However, Article 1(a) states that the insurance premium excise tax

> is covered only to the extent that the foreign insurer does not reinsure ... risks with a person not entitled to exemption from such tax under this or another convention.[1]

Article 6(1) states that industrial or commercial profits of a resident of one of the Contracting States is taxable only in the State of residence, unless the resident is engaged in industrial or commercial activity in the other State through a permanent establishment. Article 6(8) includes income from insurance activities in the definition of "industrial or commercial profits".

In order for the exemption from the insurance premium excise tax to apply, a French insurance company must meet the requirements of Article 24A of the Convention. One requirement is that the French company be a resident of France. Certain other requirements were added to the Convention by a Protocol that was ratified by the U.S. Senate on December 29, 1988 and that applies for purposes of the excise tax to taxable periods beginning on or after December 29, 1988. Thus, the requirements added to Article 24A by the 1988 Protocol apply to the year under examination (i.e., 1989).

The 1988 Protocol added limitations to Article 24A of the Convention that effectively deny benefits to a resident of one of the Contracting States under certain circumstances. Paragraph (1) of Article 24A, as amended by the Protocol, denies benefits to a person other than an individual unless

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[1]/ The Treasury Department's Technical Explanation of this provision states that "[t]he limitation on coverage is to clarify that persons not entitled to the benefits of this or another treaty ... [may not use] an insurer in a treaty country (in this case, France) as a conduit for the purpose of obtaining treaty benefits."

a) more than 50 percent of the beneficial interest in such person (or, in the case of a corporation, more than 50 percent of the number of shares of each class of the corporation's shares) is owned, directly or indirectly, by any combination of one or more of:

(i) individuals who are residents of the United States;
(ii) citizens of the United States;
(iii) individuals who are residents of France;
(iv) corporations in whose principal class of shares there is substantial and regular trading on a recognized stock exchange as defined in paragraph 3; and

* * *

b) not more than 50 percent of the gross income of such person is used, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are not residents of the Contracting States, one of the Contracting States or its local authorities, or political subdivisions of the United States or citizens of the United States.

However, Article 24A(2) provides that paragraph (1) will not apply

> if the establishment, acquisition and maintenance of such person and the conduct of its operations did not have as one of its principal purposes the purpose of obtaining benefits under the Convention.

Under Article 24A(3), the provisions of paragraph (1) do not apply to a corporation "in whose principal class of shares there is substantial and regular trading on a recognized stock exchange."

Over the years, the IRS has implemented at least two procedures by which U.S. persons paying premiums to foreign insurance companies may determine whether the foreign company is entitled to benefits under a treaty providing an exemption from the insurance premium excise tax.

In Rev. Proc. 81-2, 1982-1 C.B. 617, the IRS provided a procedure by which a U.S. person could determine whether premiums paid to French insurance companies were exempt from the tax. The revenue procedure also applied to treaties with four other countries. Importantly, all of the treaties covered by Rev. Proc. 81-2 required only that the foreign insurance company must satisfy for benefits - that is, that the insurance company be a resident of the treaty country and that the risks not be reinsured with a company not entitled to a treaty exemption from the tax.[2]/ The revenue procedure states that a U.S. person paying a premium to a French insurer may consider the treaty exemption to apply if the U.S. person has at the time a premium is paid a copy of a list of resident insurers or of an individual residency certificate issued by the French tax authorities. The revenue procedure also states that if the treaty exemption applies only to the extent the risk covered by the premium is not reinsured with a company not entitled to a treaty benefit

> the person required to remit the tax must obtain from the foreign insurer or reinsurer and retain for each policy a certificate signed under penalties of perjury, stating the name and address of the foreign insurer or reinsurer, the date the certificate was signed, the date the policy was issued, whether the risks covered by the policy have been reinsured and if so, the name of the reinsurer, the country of residence of such reinsurer and the extent to which such risks have been reinsured.

You have forwarded a copy of a certificate that [redacted] provided to taxpayer on [redacted], indicating that the policy in question, effective [redacted], will be reinsured with three other French companies: [redacted], [redacted], and [redacted] to the extent of [redacted]%, [redacted]%, and [redacted]%, respectively. This certificate was issued to comply with the requirements of Rev. Proc. 81-2.

However, Rev. Proc. 81-2 was superseded, effective December 10, 1984, by Rev. Proc. 84-82, 1984-2 C.B. 779. Rev. Proc. 84-82 states that a U.S. person may consider a premium paid to a foreign insurance company to be exempt from the excise tax under a treaty providing a qualified exemption

> only if, prior to filing the return for the taxable period, such person has knowledge that there was in effect for such taxable period a closing agreement ... between the insurer or reinsurer and the Commissioner of Internal Revenue for the insurer or reinsurer to be liable as a United States taxpayer for Federal excise tax

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[2]/ As pointed out above, significant other requirements were added to the French Convention in a 1988 protocol.

due under section 4371 et seq. ... on premiums from policies reinsured with reinsurers that are not entitled to exemption from the excise tax under the treaty or any other convention.

Rev. Proc. 84-82 is modified by Rev. Proc. 87-13, 1987-1 C.B. 596, effective April 13, 1987.

Rev. Proc. 84-82 and Rev. Proc. 87-13 state that a U.S. person may consider a premium paid to a foreign insurance company exempt from the excise tax only if the U.S. person has knowledge of the existence of a closing agreement between the insurance company and the IRS. We think, however, that a premium may be exempt from the excise tax even if paid to a foreign company that does not have a closing agreement with the IRS, provided the U.S. person can establish that the foreign insurance company qualified for a treaty exemption at the time the premiums were paid.

The premiums in question were paid by taxpayer to [redacted] during [redacted]. On [redacted], the IRS and [redacted] entered into a closing agreement with the IRS, a copy of which was faxed to you on [redacted]. Paragraph (6)(a) of the closing agreement states that

[redacted]

Furthermore, under paragraph (1) of the closing agreement, [redacted] agreed to be liable for the excise tax

[redacted]

In connection with the closing agreement, [redacted] was required to provide the IRS with a letter of credit in the amount of $[redacted] from which the IRS may draw to satisfy any liability of the company arising under the closing agreement.

If the premiums in issue were paid by taxpayer to [redacted] prior to [redacted], the effective date of the closing agreement, we think that taxpayer is technically required to establish that [redacted], as well as the three other French insurance companies that assumed parts of taxpayer's risk, were qualified for benefits under the French convention. Taxpayer's burden is not satisfied by the exemption certificate that [redacted] provided under Rev. Proc. 81-2, primarily because the certificate gives no information or basis to conclude that the requirements of Article 24A of the Convention are satisfied with respect to [redacted] and the three other French companies.[3]/ However, the IRS's determination that [redacted] qualifies for treaty benefits was based on facts submitted in late [redacted]. Therefore, it can be assumed that the company qualified for treaty benefits during all of [redacted]. Under these circumstances, you might decide to not question the exemption for premiums paid to [redacted] on or after [redacted].

If the premiums in issue were paid by taxpayer on or after [redacted], the IRS is barred from asserting that taxpayer is liable for the excise tax. However, under the closing agreement between the IRS and [redacted], the latter is liable for the excise tax, unless it can establish that the companies to which it retroceded the risks qualified for exemption under the French Convention at the time [redacted] paid the premiums to these companies.

The extent of [redacted]'s liability is described in paragraph (2)(b) of the closing agreement. The liability is the tax computed on the percentage of the premium paid by the U.S. person that is the percentage of the policy reinsured by [redacted] with the nonqualified reinsurer. The tax rate is the rate that would have applied if the premium paid to the company by taxpayer had been taxable. If the amount of the reinsurance premiums are de minimus or if the companies providing reinsurance for [redacted] appear to be bona fide and not conduits, the Service may choose to not require the French insurer to present the substantial amount of information necessary to establish a reinsurer's entitlement to treaty benefits.

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[3]/ We have no knowledge of the IRS having entered into closing agreements with any of these three companies.

If you have any questions, please call Ed Williams at FTS 287-4851.

GEORGE M. SELLINGER

cc: District Counsel, Milwaukee